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No. 96-928

In the Supreme Court of the United States

OCTOBER TERM, 1996

WELLS FARGO BANK, N.A., PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FEDERAL CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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QUESTION PRESENTED

Whether the court of appeals correctly held that the United States is not liable for profits that petitioner alleges it lost because of reductions in its capital resulting from the government's breach of a loan guarantee agreement.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-25a) is reported at 88 F.3d 1012. The opinions of the United States Court of Federal Claims (Pet. App. 27a-58a, 61a-86a) are reported at 33 Fed. Cl. 233 (1995) and 26 Cl. Ct. 805 (1992).

JURISDICTION

The judgment of the court of appeals (Pet. App. 26a) was entered on July 2, 1996. A petition for rehearing (Pet. App. 60a) was denied on September 11, 1996. The petition for a writ of certiorari was filed on December 10, 1996. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. The Rural Development Act of 1972, Pub. L. No. 92-419, § 118, 86 Stat. 657, 663 (currently codified at 7 U.S.C. 1932(a)), authorized the Farmers Home Administration (FmHA) of the Department of Agriculture to administer a program to

> make and insure loans to public, private, or cooperative organizations * * * for the purpose of improving, developing, or financing business, industry, and employment and improving the economic and environmental climate in rural communities. * * * Such loans, when originated, held, and serviced by other lenders, may be guaranteed by the Secretary [of Agriculture].

Pursuant to the FmHA's implementing regulations, a prospective lender and borrower could apply to the agency to obtain a Conditional Commitment for Guarantee. The Conditional Commitment identified the conditions and prerequisites that the parties were required to satisfy in order for the agency to issue a guarantee on the loan. See 7 C.F.R. 1980.452 (1982).[1]

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[1] The maximum loss to the lender covered by a guarantee could not exceed

> the lesser of (a) 90 percent of the principal and interest indebtedness as evidenced by [the loan note guarantee] or by assumption agreement(s), any loan subsidy due, and 90 percent of principal and interest indebtedness on secured protective advances for protection and preservation of collateral made with FmHA's authorization; or (b) 90 percent of the principal advanced to or assumed by the borrower under said [loan note guarantee] or assumption agreement(s) and any interest due []including any loan subsidy thereon.

7 C.F.R. 1980.20 (1982).

2. In 1982, Mid-Kansas Savings and Loan of Wichita (Mid-Kansas) applied to the FmHA for a guarantee of a $20 million proposed loan to High Plains Corporation (High Plains)[2] to build an ethanol plant in Kansas. The FmHA executed a Conditional Commitment to High Plains and Mid-Kansas to issue a 90 percent guarantee, and petitioner then loaned High Plains the $20 million. Pet. App. 5a-6a.

Following construction of the ethanol plant, High Plains, petitioner, and the FmHA signed an Intercreditor Agreement, which stated, *inter alia*, that an FmHA loan guarantee had not been issued "due primarily to difficulties in achieving adequate production levels at the Plant," and that additional financing was being considered by petitioner to bring the plant up to production levels and "to cause the FmHA Guarantee to be issued." Pet. App. 64a. Petitioner then loaned the additional funds to High Plains, which successfully modified the plant to meet production levels. *Ibid.* Petitioner also replaced Mid-Kansas as lead lender (*id.* at 64a-65a), and the FmHA issued a new Conditional Commitment. *Id.* at 7a.

The FmHA subsequently declined, on various grounds,[3] to issue a loan guarantee. Pet. App. 8a. Petitioner then twice restructured its loans to High

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[2] At the time of this transaction, High Plains was called American Gasohol Refiners, Inc. Pet. App. 5a.

[3] The FmHA declined to issue the loan guarantee on the grounds that "[t]here ha[d] been an adverse change in the financial condition of High Plains Corporation [since] * * * issuance of the Conditional Commitment," and that "[t]he history of the management of the corporation reveal[ed] numerous decisions which have caused adverse results and led [the FmHA] to have serious concerns about the credibility of its management." Pet. App. 8a.

Plains. In the first restructuring, petitioner received options to purchase 84 percent of High Plains' stock and reduced the loan balance by $12,700,000. In the second restructuring, petitioner surrendered the options in exchange for $2,500,000 in cash. *Ibid.* Petitioner later agreed to forgive the remaining $389,423 indebtedness owed to it by High Plains in exchange for the proceeds of a public stock offering by High Plains. *Id.* at 8a-9a.

3. On January 22, 1988, petitioner filed suit in the United States Claims Court[4] seeking a determination that the FmHA had breached a contract with petitioner to issue a guarantee on its loan to High Plains. Pet. App. 61a, 68a. The Claims Court granted summary judgment for petitioner, holding that petitioner had fulfilled its obligations under the Conditional Commitment, and that the FmHA had breached its obligations under that Commitment to issue the loan guarantee. *Id.* at 61a-62a, 69a-86a.

Following a trial on the issue of damages, the Court of Federal Claims awarded petitioner $10,885,423.86. Pet. App. 27a-59a. That sum consisted of two components: (1) the $389,423 "shortfall" forgiven by petitioner in conjunction with its receipt of the proceeds of High Plains' stock offering (*id.* at 34a-35a, 48a-50a), and (2) $10,496,000 in "lost capital damages"—*i.e.*, damages for revenues petitioner claimed it lost on loans that it would have made if its capital had not been reduced as a result of failing to obtain a govern-

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[4] On October 29, 1992, the United States Claims Court became the United States Court of Federal Claims. See Court of Federal Claims Technical and Procedural Improvements Act of 1992, Pub. L. No. 102-572, § 902(b), 106 Stat. 4516 (codified at 28 U.S.C. 171 note).

ment guarantee of the High Plains loan. *Id.* at 35a, 50a-54a.

The award for "lost capital damages" was based on petitioner's having charged off $9.7 million of the High Plains loan, which reduced its capital by that amount under applicable accounting principles. Pet. App. 35a. The court found that, but for that reduction in capital, petitioner would have made additional loans of up to 15 times that amount, and would have realized a 14% rate of return on those additional loans. *Ibid.* The court determined that that lost income amounted to $6,849,000. *Ibid.* In addition, the court found that petitioner's capital was reduced temporarily because petitioner could not treat the interest received from High Plains as income while the loan was classified as risky. *Id.* at 36a. The court found that petitioner lost $3,647,000 in revenues on additional loans that it would have made if the High Plains interest payments could have been treated as income (thereby increasing petitioner's capital by a like amount) when they were received. *Ibid.*

The court denied petitioner's claim for an additional $26,264,000 in damages based on profits petitioner argued that it expected to make from the sale of its equity interest in High Plains. Pet. App. 37a-38a, 54a-58a. The court concluded that those purported damages were not recoverable because they did "not meet the standards of foreseeability and certainty." *Id.* at 55a. The court also held that an equity interest in High Plains was not an interest protected by the loan guarantee contract. *Ibid.*

4. The court of appeals affirmed in part and reversed in part. Pet. App. 1a-25a. It agreed with the Court of Federal Claims that the FmHA had breached its contract with petitioner, but limited damages to

the $389,423 shortfall that petitioner failed to recover on the guaranteed portion of the High Plains loan. *Id.* at 1a-25a. The court of appeals reversed the award of $10,496,000 in lost capital damages, holding that the failure to obtain anticipated profits on business transactions unrelated to the loan at issue was "too remote and uncertain" and not a foreseeable consequence of the government's breach. *Id.* at 22a; see also *id.* at 20a-21a. The court affirmed the rejection of petitioner's claim for damages for its surrender of its equity interest in High Plains, agreeing with the Court of Federal Claims that those claimed damages were not foreseeable or certain, and that the equity interest was not protected by the loan guarantee contract. *Id.* at 24a-25a.

ARGUMENT

1. Petitioner's central contention (Pet. 14) is that the court of appeals adopted "a unique rule, excusing the United States from liability" for foreseeable damages flowing from the breach of its contract with petitioner. That contention misconstrues the court of appeals' decision.

As petitioner acknowledges (Pet. 15), it is well established that "consequential damages, such as lost profits, [must] be a foreseeable result of the breach" in order to be awarded in a common-law contract suit. *East River S.S. Corp.* v. *Transamerica Delaval Inc.*, 476 U.S. 858, 874 (1986) (citing *Hadley* v. *Baxendale*, 156 Eng. Rep. 145 (1854)). This Court long ago recognized, as a matter of federal common law, that a breaching party is responsible only "for such consequences as may be reasonably supposed to be in the contemplation of the parties at the time of making the

contract." *Globe Refining Co.* v. *Landa Cotton Oil Co.*, 190 U.S. 540, 544 (1903) (Holmes, J.).

The decision of the court of appeals in this case is fully consistent with that principle. The court awarded petitioner $389,423 in damages arising from High Plains' failure to repay its loan—the only loan that the government erroneously declined to guarantee. The court found that amount to be within the contemplation of the parties, because nonpayment of a risky loan was "one of the contingencies against which the guarantee was intended to protect the lender." Pet. App. 23a-24a.

The court of appeals correctly concluded, however, that petitioner was not entitled to recover lost profits on collateral loans. Pet. App. 20a-22a. Neither the Conditional Commitment nor the Intercreditor Agreement signed by the parties contemplated the FmHA's potential liability for petitioner's lost profits on loans that might have been made to third parties. Those documents, as well as the FmHA's governing regulations, addressed only the FmHA's liability to petitioner in the event that High Plains defaulted on its loan. In light of the terms of the regulations and the documents signed by the parties, the court of appeals correctly held that the only losses that were foreseeable were those directly related to the loan that the Conditional Commitment induced petitioner to make to High Plains. *Id.* at 22a. Indeed, because lost profits on collateral transactions have been denied for at least a century under federal common law,[5] petitioner could not reasonably have expected

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[5] See, *e.g.*, *Northern Helex Co.* v. *United States*, 524 F.2d 707, 720 (Ct. Cl. 1975), cert. denied, 429 U.S. 866 (1976); *Ramsey* v. *United States*, 101 F. Supp. 353, 357-358 (Ct. Cl. 1951),

that such profits would be recoverable at the time the contract in this case was formed. See *Globe Refining Co.*, 190 U.S. at 544 (amount of recoverable damages "depends on what liability the defendant fairly may be supposed to have assumed consciously, or to have warranted the plaintiff reasonably to suppose that it assumed, when the contract was made").

Petitioner contends (Pet. 17) that the court of appeals held "that there can never be damages for losses to 'independent and collateral undertakings,' even if foreseeable." To the contrary, the court of appeals determined that the lost profits alleged by petitioner were *not* foreseeable. See Pet. App. 22a ("[W]e approach the question differently, and do not agree with the Court of Federal Claims's holding that the lost capital damages claimed by [petitioner] were foreseeable at the time of contracting.") (internal quotation marks omitted); *id.* at 23a ("[T]he lost profits * * * were not foreseeable when the government executed the Conditional Commitment.").

Petitioner therefore errs in contending (Pet. 18-19) that the court of appeals' holding conflicts with *United States* v. *Winstar Corp.*, 116 S. Ct. 2432 (1996), and other decisions of this Court which hold that the United States is ordinarily liable under its contracts to the same extent as private parties in similar cases. The court of appeals' decision in this case did not relieve the government of any obligations under federal common law that would apply to private parties.[6]

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cert. denied, 343 U.S. 977 (1952); *Myerle* v. *United States*, 33 Ct. Cl. 1, 26 (1897).

[6] The court of appeals' reference (Pet. App. 18a) to *Northern Helex Co.* v. *United States*, 524 F.2d at 720, in which the court observed that the rule against "remote and consequential

2. In addition to barring damages for consequences that are not foreseeable at the time the parties entered a contract, the common law has long prohibited the award of damages that are remote or speculative. "Profits which are a mere matter of speculation cannot be made the basis of recovery in suits for breach of contract." *Anvil Mining Co.* v. *Humble*, 153 U.S. 540, 549 (1894); see also *United States* v. *Penn Foundry & Mfg. Co.*, 337 U.S. 198, 208 & n.5 (1949); *Howard* v. *Stillwell & Bierce Mfg. Co.*, 139 U.S. 199, 206 (1891). Here, petitioner's claim rests on the assumptions (1) that, in the absence of the government's breach, petitioner would have been able to use loan payments from High Plains as capital, and that 15 times the amount of that capital would have been available to make additional loans; (2) that customers would have been available to borrow that additional amount of leveraged capital; and (3) that petitioner would have earned its historical average rate of return (14%) on those loans. In light of the speculative nature of those assumptions, the court of appeals properly rejected the trial court's award of lost profits. Pet. App. 22a, 23a.[7]

3. Petitioner contends (Pet. 16) that "the Federal Circuit's holding is contrary to the rule applied in other courts." Petitioner relies on cases decided

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damages" applies "especially * * * in suits against the United States," does not undermine this conclusion. Nothing in the court's subsequent legal analysis suggests that it adopted a special rule applicable only to the United States.

[7] As the court of appeals recognized (Pet. App. 25a), petitioner's claimed damages relating to the surrender of its equity interest in High Plains were "even more remote and conjectural" than its claim for lost profits. Petitioner does not appear to challenge that aspect of the decision below.

under state law, which hold that "damages from injury to independent or collateral undertakings are recoverable where they were legally foreseeable at the time of contracting." *Ibid.* (citing, *e.g.*, *Independent Mechanical Contractors, Inc.* v. *Gordon T. Burke & Sons, Inc.*, 635 A.2d 487 (N.H. 1993)). The court below, however, concluded, under federal common-law principles, that petitioner's claimed damages were *not* foreseeable, and were too remote and speculative to permit recovery. See Pet. App. 20a-21a, 22a-23a. Moreover, none of the cases cited by petitioner addresses the question presented here: whether a bank may recover lost profits on loans never made due to the breach of a loan guarantee agreement. Those cases do not conflict with the decision below.

4. Petitioner next contends (Pet. 21) that the court of appeals committed "fundamental error" when it observed that "attempting to determine what could have happened if the guarantee had been issued necessarily involves a highly speculative and conjectural inquiry." Pet. App. 18a. Petitioner suggests that this statement conflicts with this Court's decisions in *Bigelow* v. *RKO Radio Pictures, Inc.*, 327 U.S. 251 (1946), and *Story Parchment Co.* v. *Paterson Parchment Paper Co.*, 282 U.S. 555 (1931). Both of those cases, however, concerned damage awards for violations of the antitrust statutes, which the Court appeared to view as more analogous to tortious conduct than to breach of contract. See *Bigelow*, 327 U.S. at 264; *Story Parchment*, 282 U.S. at 563; see also *Associated General Contractors of California, Inc.* v. *California State Council of Carpenters*, 459 U.S. 519, 547 (1983) (Marshall, J., dissenting). "Courts have traditionally required greater certainty

in the proof of damages for breach of a contract than in the proof of damages for a tort." Restatement (Second) Contracts § 352, cmt. a (1981); see also *Exxon Co., U.S.A.* v. *Sofec, Inc.*, 116 S. Ct. 1813, 1819 (1996) ("the requirement of foreseeability may be more stringent in the context of contract liability than it is in the context of tort liability"). Moreover, the Court in *Bigelow* recognized that, even in antitrust cases, damages may not be based "on speculation or guesswork." 327 U.S. at 264. Here, the court of appeals found it to be speculative whether petitioner would have made any profits at all on collateral loan transactions, let alone whether such transactions would have resulted in the more than $10 million in profits that petitioner seeks to recover.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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